

STATEMENT OF DISCIPLINARY ACTION

A. The Disciplinary Action

1. Pursuant to sections 37CA and 37I(1A) of the Accounting and Financial Reporting Council Ordinance (Cap. 588) (**AFRCO**), the Accounting and Financial Reporting Council (**AFRC**) has:
 - 1.1. publicly reprimanded each of BDO Limited (**BDO**), Alfred Lee (**Lee**), and Pak Tak Lun Amos (**Pak**);
 - 1.2. imposed a pecuniary penalty of **HK\$245,000** against BDO;
 - 1.3. imposed a pecuniary penalty of **HK\$154,000** against Lee;
 - 1.4. imposed a pecuniary penalty of **HK\$56,000** against Pak; and
 - 1.5. directed Lee and Pak to:
 - 1.5.1 undertake 20 and 10 verifiable continuing professional development (**CPD**) hours¹ respectively on specified areas within 12 months from the date of the issuance of the Decision Notice to Lee² and Pak³; and
 - 1.5.2 provide the AFRC with evidence of compliance with paragraph 1.5.1 above within three months upon the expiry of the 12-month period

(collectively, **Disciplinary Action**).
2. The Disciplinary Action was taken in relation to the audit of the consolidated financial statements of Vestate Group Holdings Limited (in Liquidation)

¹ The 20 verifiable CPD hours for Lee and 10 verifiable CPD hours for Pak shall be in addition to any requirements applicable to Lee and Pak in connection with any professional licence (including those as set out in Statement 1.500 (*Continuing Professional Development*) issued by the Hong Kong Institute of Certified Public Accountants (**HKICPA**)).

² In relation to Lee, (a) 10 verifiable CPD hours shall focus on (i) auditing accounting estimates and related disclosures under Hong Kong Standard on Auditing (**HKSA**) 540 (*Auditing Accounting Estimates and Related Disclosures*) (**HKSA 540**), and (ii) assessment of the quality and reliability of the work of the auditor's expert under HKSA 620 (*Using the Work of an Auditor's Expert*) (**HKSA 620**); and (b) 10 verifiable CPD hours shall focus on (i) applying, reviewing and documenting the application of professional judgment under HKSA 200 (*Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Hong Kong Standards on Auditing*) (**HKSA 200**) and (ii) evaluation of the sufficiency and appropriateness of audit evidence under HKSA 500 (*Audit Evidence*) (**HKSA 500**).

³ In relation to Pak, (a) 5 verifiable CPD hours shall focus on (i) auditing accounting estimates and related disclosures under HKSA 540, and (ii) assessment of the quality and reliability of the work of the auditor's expert under HKSA 620; and (b) 5 verifiable CPD hours shall focus on (i) applying, reviewing and documenting the application of professional judgment under HKSA 200, and (ii) performing the engagement quality control review under Hong Kong Standard of Quality Management 2.

(delisted, previous stock code: 01386) (**Company**) and its subsidiaries (collectively, **Group**) for the year ended 31 March 2018 (**2018 Financial Statements**).

3. BDO⁴ conducted the audit of the 2018 Financial Statements (**2018 Audit**). Lee⁵ was the engagement partner (together with BDO, **Auditor**) and Pak⁶ was the engagement quality control reviewer (**EQCR**) for the 2018 Audit. The Auditor and the EQCR are referred to together as the **Regulatees**.
4. The AFRC found a number of audit deficiencies in the 2018 Audit concerning, among other things, the impairment assessment of the Group's point-of-sale and e-commerce payment processing business (**E-Business**) in the five regions of Hong Kong, Japan, Korea, Italy and France (**Five Regions**) authorised by UnionPay International Co., Ltd. (**UnionPay**), an international payment service provider. Most significantly:
 - 4.1. The valuation of the E-Business was identified as a matter with significant risk of material misstatement and one of the key audit matters.
 - 4.2. Since impairment assessment based on the discounted cash flow method relies on future cash flow projections, revenue forecasts are critical as they directly impact the expected cash flow that an asset can generate.
 - 4.3. However, the Auditor failed to obtain and review the calculation of the forecasted revenue of the E-Business or properly assess the reasonableness of the revenue growth rates used in the valuation of the E-Business prepared by the Company's valuer (**Valuer**).
 - 4.4. The Auditor also failed to obtain sufficient appropriate audit evidence to support the key assumption adopted by the Valuer that the E-Business would generate revenue for a long-term period of 24 years, notwithstanding the Licence (as defined below) to operate the E-Business had been granted to the Company on a provisional basis only.
 - 4.5. Instead, the Auditor inappropriately relied on the assessment prepared by the valuation expert engaged by BDO (**Expert**) without properly evaluating the adequacy of the Expert's work, even though the relevant standards provide that the Auditor had the sole

⁴ BDO is registered as a corporate practice and a public interest entity auditor with the AFRC (registration number: M0200).

⁵ Lee is a member of the HKICPA (A08833) and currently holds a practising certificate (P04960). He is currently a practising director, a registered engagement partner and a registered engagement quality control reviewer of BDO.

⁶ Pak is a member of the HKICPA (A17525) and currently holds a practising certificate (P06170). He is currently a practising director, a registered engagement partner and a registered engagement quality control reviewer of BDO.

responsibility for the audit opinion expressed, and that responsibility is not reduced by the Auditor's use of an expert.

5. The AFRC also found that the EQCR had failed to identify key audit deficiencies despite having reviewed the audit documentation relating to the impairment assessment of the E-Business and discussed the issue with the engagement team.
6. As a result, the AFRC found that the Auditor and EQCR had failed or neglected to observe, maintain or otherwise apply the following PAO professional standards⁷ in the 2018 Audit:
 - 6.1. for the Auditor:
 - 6.1.1 paragraphs 15, 16, A21 and A25 of HKSA 200 (June 2017);
 - 6.1.2 paragraphs 6, 7 and 9 of HKSA 500 (June 2017);
 - 6.1.3 paragraphs 12(b) and 18 of HKSA 540 (June 2017); and
 - 6.1.4 paragraphs 11, 12, 13, A33 and A34 of HKSA 620 (July 2010);
 - 6.2. for Lee: paragraphs 15 and 17 of HKSA 220 (*Quality Control for an Audit of Financial Statements*) (June 2017) (**HKSA 220**); and
 - 6.3. for Pak: paragraphs 20 and 21 of HKSA 220.
7. By failing or neglecting to observe, maintain or otherwise apply the above PAO professional standards in the 2018 Audit, each of BDO, Lee and Pak is guilty of CPA misconduct pursuant to section 71 of the Accounting and Financial Reporting Council (Transitional and Saving Provisions and Consequential Amendments) Regulation (Cap. 588B) (**Transitional Regulation**), and the AFRC may impose sanctions against them under section 37CA of the AFRCO and/or take actions against them under section 37I of the AFRCO.

B. Summary of Facts

B.1 Acquisition and disposal of China Consume Group

8. The Group was principally engaged in the retailing of footwear in Hong Kong, the PRC and Taiwan, and the E-Business.
9. In February 2017, the Group acquired China Consume Financial Holdings Company Limited (**China Consume**) and its subsidiaries (together, **China Consume Group**) from Golden Ahead International Limited for a consideration of approximately HK\$178.7 million (**Acquisition**).

⁷ As defined in section 2 of the AFRCO.

10. The China Consume Group held a licence to carry out the E-Business in the form of a provisional letter of authorisation issued by UnionPay dated 3 December 2015 (**Licence**). The Group obtained the Licence through the Acquisition.
11. The Licence was granted on a provisional basis only and provided that if China Consume's application for UnionPay membership was rejected, it was required to terminate the conduct of the E-Business within 30 days from the date of the notice of rejection.
12. The E-Business did not generate any revenue for the Group and incurred losses of HK\$0.4 million and HK\$2.7 million for the years ended 31 March 2017 and 2018 respectively.
13. In August 2017, the Group entered into a memorandum of understanding with a potential buyer for the disposal of not less than 60% equity interest in China Consume at a consideration of not less than HK\$185 million.
14. In June 2018, the Group entered into another memorandum of understanding with another potential buyer to dispose of the remaining 40% equity interest in China Consume at a market valuation to be determined at the time of disposal.

B.2 Impairment assessment of the E-Business

15. In light of the Group's intention to dispose of its interests in China Consume and based on the expectation that the proposed disposal would be completed by the end of 2018, the net assets of the E-Business were classified as held-for-sale in the 2018 Financial Statements.
16. The net assets of the E-Business represented approximately 26% of the Group's total assets of HK\$734.6 million or around five times of the Group's net assets of HK\$37.2 million as at 31 March 2018, and mainly comprised:
 - 16.1 the Licence with a carrying amount of around HK\$193.6 million; and
 - 16.2 goodwill of approximately HK\$36.2 million recognised by the Group upon the Acquisition.
17. An impairment review was required for the measurement of the non-current assets related to the E-Business by reason of its initial classification as held-for-sale.
18. Under HKFRS 5 (*Non-current Assets Held for Sale and Discontinued Operation*) applicable at the material time and the Company's accounting policy, the non-current assets of the E-Business, being classified as held-for-sale, should be measured at the lower of its carrying amount and fair value less costs to sell.

19. For the purpose of carrying out the impairment assessment of the E-Business, the Valuer was to determine the fair value less costs of disposal of China Consume as at 31 March 2018 (**Valuation**).
20. The Valuation was determined using the discounted cash flow method under the income approach, by converting the estimated cash flows for each financial year in the forecast period from 2019 to 2042 to the present value using a discount rate. The Valuer determined the Valuation to be HK\$193 million by using this method.
21. The calculations used by the Valuer to determine the Valuation involved, among other things, the cash flow projection (**CF Projection**) which set out the forecasted financial results and the forecasted cash flows for the 24-year period from 2019 to 2042. The CF Projection applied revenue growth rates ranging from 10% to 128% for the 2019 to 2028 financial years, and long-term growth rate of 3% from the 2029 financial year onwards.
22. The Company determined that no impairment was recognised in the 2018 Financial Statements because the fair value less costs of disposal (HK\$193 million) exceeded the carrying amount of the net assets classified as held-for-sale (HK\$189.4 million).
23. BDO was the auditor of the 2018 Financial Statements and expressed an unmodified opinion on the same with an emphasis of matter paragraph about the material uncertainty as to the Group's ability to continue as a going concern.
24. In the 2018 Audit, the valuation of the E-Business was identified as a matter with significant risk of material misstatement and a key audit matter which required significant audit attention.

C. Summary of Findings

C.1 Inadequate audit procedures on the impairment assessment

25. Pursuant to HKSA 500, the Auditor was required to design and perform audit procedures to obtain sufficient appropriate audit evidence to support the Auditor's audit opinion on the 2018 Financial Statements.
26. Further, HKSA 540 required the Auditor to obtain sufficient appropriate audit evidence about whether the accounting estimates of the Valuation were reasonable in the context of the applicable financial reporting framework for the impairment assessment of the E-Business.
27. However, the Auditor failed to carry out sufficient audit procedures to obtain sufficient appropriate audit evidence in relation to the impairment assessment of the E-Business, including, in particular, the accounting estimates of the Valuation.

C.1.1 Forecasted revenue

28. The audit working papers did not include any analysis of the calculation of the forecasted revenue for any year in the CF Projection, as well as the parameters used for calculating the forecasted revenue, notwithstanding the Auditor's assertion in its submissions to the AFRC that it had purportedly reviewed the calculation.
29. In its submissions, the Auditor sought to rely on a document titled "*China Consume Financial Holdings Company Limited Business Plan*" (**Business Plan**) and a report titled "*Global Chinese Shoppers*" issued by a third-party business intelligence centre dated 22 September 2015 (**Third Party Report**) as audit evidence to support the forecasted revenue for the 2020 financial year, even though the Business Plan and Third Party Report did not provide information as to how management's estimates were arrived at. Therefore, the Auditor failed to properly evaluate the relevance and reliability of the Business Plan and Third Party Report and seek corroborative evidence from management to support the assumptions made in relation to forecasted revenue.
30. By reason of the above, the AFRC considered that the Auditor failed to:
 - 30.1 obtain sufficient appropriate evidence to support the reasonableness of the forecasted revenue in the CF Projection, in breach of HKSA 500.6 and HKSA 540.18;
 - 30.2 evaluate whether the forecasted revenue was sufficiently reliable, including whether it was sufficiently precise and detailed, for the purpose of the CF Projection, in breach of HKSA 500.9; and
 - 30.3 consider the relevance and reliability of the Business Plan and the Third Party Report used as audit evidence, in breach of HKSA 500.7.

C.1.2 Revenue growth rates

31. The Auditor did not obtain any industry data or market data to support the reasonableness of the revenue growth rates (of up to 128%) used in each year for the 2021 to 2042 financial years.
32. The Auditor also did not obtain adequate information as to how the revenue growth rates were determined by management and merely carried out a purported internet search (which was not documented in the audit working papers) for market indices to support the revenue growth rates.
33. By reason of the above, the AFRC found that the Auditor failed to obtain sufficient audit evidence to support the reasonableness of the revenue growth rates, in breach of HKSA 500.6 and HKSA 540.18.

C.1.3 Status of licences for operating the E-Business

34. For the purpose of the CF Projection, it was assumed by the Valuer that China Consume had obtained all necessary permits, business certificates, licences and legal approvals to operate the E-Business. On the above basis, it was determined that the E-Business would generate revenue for a long-term period of 24 years starting from the 2019 financial year.
35. However, as stated in paragraph 11 above, the Licence had been granted on a provisional basis only. If China Consume's application for UnionPay membership was rejected, it was required to terminate the conduct of the E-Business within 30 days from the date of the notice of rejection.
36. As at 31 March 2018, China Consume was not eligible to apply for UnionPay membership or a formal licence to carrying out the E-Business from UnionPay because it had not yet obtained the required licences from the relevant authorities (including a money service operator licence in Hong Kong).
37. However, the audit working papers did not record (a) any information about the Group's application for the UnionPay membership and the formal licence, or the licences required for operating the E-Business in the Five Regions; and (b) the Auditor's evaluation of the appropriateness of the operation period of the E-Business assumed in the CF Projection.
38. Furthermore, the Auditor did not obtain any information about the costs required for obtaining the necessary licences and assess whether the costs had been reflected in the CF Projection.
39. The Auditor submitted, among other things, that the risk of UnionPay rejecting China Consume's application for membership had already been reflected in the Company's specific risk premium of 13.5%, and such risk had been factored in the Valuation.
40. However, such risk was not documented in the relevant audit working papers, and the Auditor did not obtain sufficient explanations and supporting documents regarding how the company specific risk premium reflected any business risks.
41. Based on the above, the AFRC considered that the Auditor failed to perform audit procedures to obtain sufficient appropriate audit evidence in relation to the assumption of the commencement of the E-Business in the 2019 financial year in the CF Projection, in breach of HKSA 500.6.

C.1.4 Other audit deficiencies in relation to impairment assessment

(a) Capital expenditure

42. The Auditor did not obtain sufficient audit evidence to support the reasonableness of the capital expenditure for the forecast period and evaluate the appropriateness of the significant decrease in the capital expenditure

assumed in the CF Projection as compared to the forecasted amount in the valuation of the E-Business as at 31 March 2017.

43. By reason of the above, the AFRC found that the Auditor was in breach of HKSA 540.12(b).

(b) *Operating expenses / NOPAT margins*

44. Further, the Auditor concluded that the forecasted operating expenses were reasonable based on insufficient evaluation of the reasonableness of the net operating profit after tax (**NOPAT**) margins.

45. Accordingly, the AFRC found that the Auditor:

45.1 failed to obtain sufficient appropriate evidence to support the reasonableness of the forecasted operating expenses in the CF Projection, in breach of HKSA 500.6 and HKSA 540.18; and

45.2 evaluate whether the forecasted operating expenses in the CF Projection were sufficiently reliable for the auditor's purposes, in breach of HKSA 500.9(b).

C.2 Lack of evaluation of the adequacy of the Expert's work

46. Pursuant to HKSA 620, the auditor has sole responsibility for the audit opinion expressed, and that responsibility is not reduced by the auditor's use of an auditor's expert.

47. In the 2018 Audit, the Auditor engaged the Expert to review the Valuation. Among other things, the Expert assisted in reviewing the reasonableness of NOPAT margins and capital expenditures used in the Valuation, and the company specific risk premium used to calculate the discount rate for the Valuation.

48. Despite there being clear deficiencies in the work carried out by the Expert in respect of the areas mentioned in paragraph 47 above, the Auditor did not challenge the Expert's review of the Valuation and accepted the Expert's view that the key assumptions adopted in the Valuation were reasonable.

49. More specifically:

49.1 the Expert considered that the company specific risk premium used by the Valuer to calculate the discount rate for the CF Projection was broadly reasonable without seeking corroborative evidence as to how the company specific risk premium reflected the Company's business risks. In particular, the Expert did not consider whether the company specific risk premium reflected the risk of UnionPay rejecting the Group's application for formal licence. However, the Auditor did not follow up with the Expert and obtain audit evidence to support the Expert's findings;

- 49.2 the Expert did not comment on the reasonableness of the NOPAT margins used in the Valuation, but the Auditor did not follow up with the Expert, even though the NOPAT margins were outside the range of the margins of comparable companies;
 - 49.3 the Expert did not comment on the reasonableness of the forecasted capital expenditure used in the CF Projection and failed to take appropriate steps to verify the same, but the Auditor did not follow up with the Expert;
 - 49.4 the Auditor did not carry out any procedures to assess the adequacy of the Expert's work in accordance with their audit checklist and the relevant auditing standard; and
 - 49.5 the Auditor did not perform further audit procedures themselves or agree with the Expert on additional work to be performed by the Expert even though the work performed by the Expert was inadequate and could not support the conclusions reached.
50. In light of the above, the AFRC found that the Auditor was in breach of HKSA 620, in that:
- 50.1 the Auditor failed to perform specific procedures to evaluate the adequacy of the Expert's work about the relevance and reasonableness of the Expert's findings and conclusions, in breach of HKSA 620.12(a), A33 and A34;
 - 50.2 the Auditor failed to evaluate whether the work of the Expert was adequate for their audit purposes, in breach of HKSA 620.11 and 620.12; and
 - 50.3 due to the lack of such evaluation, the Auditor did not follow up with the Expert for additional work to be performed by the Expert, or carry out further audit work by themselves so as to obtain audit evidence, in breach of HKSA 620.13.

C.3 Conclusion on breaches by the Auditor

51. By reason of the above audit deficiencies, the AFRC considered that:
- 51.1 the Auditor did not perform the 2018 Audit with professional skepticism recognising that the Valuation might be overstated and cause the 2018 Financial Statements to be materially misstated in accordance with HKSA 200.15 and A21;
 - 51.2 the Auditor did not critically challenge the management's estimations by exercising professional judgment in accordance with HKSA 200.16 and A25; and

- 51.3 Lee did not adequately direct and supervise the 2018 Audit and conduct a quality review in accordance with HKSA 220.15 and 17.

C.4 Engagement Quality Control Review

52. In the audit engagement team discussion meeting on 2 May 2018, Pak, the EQCR, agreed that impairment assessment of the E-Business was a significant risk in the 2018 Audit. Pak accordingly reviewed the audit documentation in relation to the impairment assessment of the E-Business and discussed the issue with the audit engagement team. However, Pak failed to identify the audit deficiencies set out above.
53. Most significantly, the AFRC found that Pak:
- 53.1 should have, but failed to, question the audit engagement team about the audit procedures performed or evidence obtained regarding the key assumptions in the CF Projection, including the revenue growth rate of up to 128%, despite the lack of sufficient audit evidence to support the reasonableness of the same (see paragraphs 31 to 33 above);
 - 53.2 should have, but failed to, question whether the engagement team had obtained sufficient appropriate audit evidence regarding the status of the Group's application for UnionPay's formal licence or membership and evaluate the impact on the Valuation (see paragraphs 34 to 41 above);
 - 53.3 incorrectly considered that the company specific risk premium reflected multiple business risks, including the risk of not obtaining UnionPay's membership, when such assertion was not supported by sufficient work performed by the Expert or additional audit evidence obtained by the engagement team (see paragraph 49 above); and
 - 53.4 should have been, but was not, aware of the significant decrease in the capital expenditure assumed in the CF Projection as at 31 March 2017 and 31 March 2018 (see paragraph 42 above).
54. In the circumstances, the AFRC considered that Pak failed to properly perform the engagement quality control review in accordance with HKSA 220.20 and 220.21.

D. Conclusion

55. Having considered all relevant circumstances, the AFRC is of the view that each of the Regulatees has failed or neglected to observe, maintain or otherwise apply the PAO professional standards in the 2018 Audit. Each of them is therefore guilty of CPA misconduct pursuant to section 71 of the Transitional Regulation.

56. In determining the Disciplinary Action, the AFRC has had regard to its Sanctions Policy for Professional Persons, Guidelines for Exercising the Power to Impose a Pecuniary Penalty for Professional Persons and the Guidance Note on Cooperation with the AFRC (**Guidance Note on Cooperation**), and has taken into account all relevant circumstances, including those summarised in paragraphs 57 to 62 below.

D.1 Nature, seriousness, duration, frequency and impact of the misconduct

57. Having considered the admitted facts and circumstances, the AFRC takes the view that the Auditor's breaches were serious. The net assets of the E-Business in the amount of HK\$189.4 million represented approximately 26% of the Group's total assets of HK\$734.6 million or around five times the Group's net assets of HK\$37.2 million as at 31 March 2018. It also amounted to around 54 and 90 times the 2018 Audit's overall and performance materiality respectively. In light of the above, the impairment assessment of the E-Business was a significant matter which required robust and rigorous work, yet the Auditor failed to carry out appropriate audit procedures commensurate with the risks identified, and placed inappropriate reliance on the work carried out by the Valuer and the Expert without sufficient professional skepticism.

58. As the EQCR, Pak should have properly evaluated the significant judgments made and conclusions reached by the Auditor during the engagement quality control review and identified that the Auditor lacked sufficient appropriate audit evidence to support its conclusions reached in relation to the impairment assessment of the E-Business. Pak's failure to do so contributed to the Auditor's incorrect issuance of an unmodified audit opinion. In the circumstances, the AFRC considers Pak's misconduct to be moderately serious compared to the Auditor's misconduct.

59. That being said, the AFRC does not make any finding, and there was no evidence of, intentional, dishonest or deliberate misconduct.

60. The AFRC also notes that:

60.1 the Regulatees' breaches lasted for one audit year and were not recurring;

60.2 there is no evidence of material misstatement in the 2018 Financial Statements and no prior year adjustments to the 2018 Financial Statements were made; and

60.3 there was no finding of any incorrect treatment of the underlying asset being impaired.

D.2 Aggravating and mitigating circumstances

61. The AFRC has considered whether there are any aggravating and mitigating factors in this case, including the following.

Aggravating circumstances

61.1 BDO's disciplinary record and compliance history.

Mitigating circumstances

61.2 Lee and Pak have a clean disciplinary record with the AFRC and the HKICPA.

61.3 The AFRC has also taken into account the cooperation provided by the Regulatees in this case. Among other things, the Regulatees admitted their liabilities in full and initiated resolution discussions with the AFRC. The Regulatees also accepted the Disciplinary Action against each of them and entered into an agreement with the AFRC pursuant to section 37I(1A) of the AFRCO before the issuance of a Notice of Proposed Disciplinary Action against each of them. In addition to public reprimands and pecuniary penalties, Lee and Pak accepted to undertake additional CPD hours specific to the misconduct in the present case as a remedial action.

62. Having considered all the relevant circumstances in the present case and the Guidance Note on Cooperation, the AFRC is of the view that a reduction of 30% to the original pecuniary penalties assessed against each of the Regulatees is appropriate, and that it is in the interest of the investing public and the public interest for the AFRC to enter into an agreement pursuant to section 37I(1A) of the AFRCO with each of the Regulatees.